INDIRECT ENCROACHMENT ON FEDERAL AUTHORITY BY THE TAXING POWERS OF THE STATES[1] VIII

III. Summary and Conclusion

WE are often told that a state cannot tax interstate commerce or an instrumentality of the federal government. This is commonly accepted legal doctrine. But in the law, as in human life elsewhere, actions speak louder than words. What judges actually permit and prohibit is more important than what they say about their approval and their disapproval. By their fruits ye shall know them better than by their professions. If judges do in fact permit the states to tax interstate commerce and the instrumentalities of the federal government, that commerce and those instrumentalities may be taxed by the states, all doctrine to the contrary notwithstanding.

It is perhaps too much to hope that all conflict between the formulations of legal doctrine and the substantial results of legal decisions will ever be resolved. Until all catch phrases which clothe half truths in the majesty of the universal and the absolute are banished from common speech, we cannot expect the imaginary deity which calls itself The Law to be free from the foibles of its mortal makers. But those who are interested in law, not as a conceptualist vision, but as an instrument for the actual ordering of human affairs, must necessarily seek to discover how the law does actually order human affairs. They will wish to make their own formulations of the law as it is laid down and applied by those duly vested with authority in the matter. They will be unwilling to accept the formulations of others that do not square with results of the adjudications.

When in this frame of mind we approach the limitations imposed upon the taxing powers of the states by the existence of

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[1] For preceding instalments of this discussion, see 31 Harv. L. Rev. 321–72 (January, 1918); *Ibid.*, 572–618 (February, 1918); *Ibid.*, 721–78 (March, 1918); *Ibid.*, 932–53 (May, 1918); 32 Harv. L. Rev. 234–65 (January, 1919); *Ibid.*, 374–416 (February, 1919); and *Ibid.*, 634–78 (April, 1919).

the federal system of government, we find the line of demarcation by no means so clear as familiar formulations would entice us to assume. We discover that in certain ways and to a certain extent a state may tax a federal instrumentality and may tax interstate commerce. We face the problem as one of methods and of degree. We see the solution reached by compromise and by practical adjustment and not by simple discovery of a sharp boundary between two entirely separate spheres of power. We find that the law cannot be summed up in a phrase, but that we must go behind the phrases to the facts.

To Chief Justice Marshall we are indebted for clarity and confusion on the problem of marking the limits of state power. The confusion appears when he professes clarity, and the clarity is manifest when he owns up to perplexity. By neglecting the concrete and rising to the heights of political theorizing, Marshall attains an artificial simplicity which would banish all our difficulties, if words alone were adequate to the task. In *McCulloch* v. *Maryland*,[2] he tells us:

"If we measure the power of taxation residing in a State, by the extent of sovereignty which the people of a single State possess, and can confer on its government, we have an intelligible standard applicable to every case to which the power may be applied." [3]

Find the limits of state sovereignty, and all difficulties are at an end. Sovereignty is the intelligible standard applicable to every case. In praise of his solution, Marshall continues:

"We have a principle which leaves the power of taxing the people and property of a State unimpaired; which leaves to a State the command of all its resources, and which places beyond its reach, all those powers which are conferred by the people of the United States on the government of the Union, and all those means which are given for the purpose of carrying those powers into execution. We have a principle which is safe for the States, and safe for the Union. We are relieved, as we ought to be, from clashing sovereignty; from interfering powers; from a repugnancy between a right in one government to pull down what there is an acknowledged right in another to build up; from the incompatibility of a right in one government to destroy what there is a right in another to preserve. We are not driven to the perplexing inquiry, so unfit for the

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[2] 4 Wheat. (U. S.) 316 (1819). [3] *Ibid.*, 429–30.

judicial department, what degree of taxation is the legitimate use, and what degree may amount to the abuse of the power." [4]

If it were really so easy as Marshall here appears to think, the most merciful of critics could hardly condone the wanderings of his successors in the path which he pointed out. With the formula of *McCulloch* v. *Maryland* [5] before them, every dispute should have been speedily and unanimously resolved. But Marshall himself was soon to doubt the magic of his pronouncement of 1819. Eight years later in *Brown* v. *Maryland* [6] we find him aware that the notion of sovereignty is not the simple solvent that it had previously appeared to be. In 1827 he confesses:

"The constitutional prohibition on the States to lay a duty on imports, a prohibition which a vast majority of them must feel an interest in preserving, may certainly come in conflict with their acknowledged power to tax persons and property within their territory. The power, and the restriction on it, though quite distinguishable when they do not approach each other, may yet, like the intervening colours between white and black, approach so nearly as to perplex the understanding, as colours perplex the vision in marking the distinction between them. Yet the distinction exists, and must be marked as the cases arise. Till they do arise, it might be premature to state any rule as being universal in its application." [7]

Here the great Chief Justice tells us that the line between state power and absence of power is not an easy one to mark. A state tax which from one angle is an exercise of lawful authority may from another angle be an encroachment on the field reserved to the

[4] 4 Wheat. (U. S.) 430.

[5] Note 2, *supra*.

[6] 12 Wheat. (U. S.) 419 (1827).

[7] *Ibid.*, 441. Compare Chief Justice Taney in License Cases, 5 How. (U. S.) 504, 574 (1847): "It is unquestionably no easy task to mark by a certain and definite line the division between foreign and domestic commerce, and to fix the precise point, in relation to every imported article, where the paramount power of Congress terminates, and that of the State begins. They cannot be determined by the laws of Congress or of the States, as neither can by its own legislation enlarge its own powers, or restrict those of the other. And as the Constitution itself does not draw the line, the question is necessarily one for judicial decision, and depending altogether upon the words of the Constitution." That the words of the Constitution have to be supplemented by something extraneous is hinted by the previous recognition that the Constitution itself does not draw the line. How little the words of the Constitution have to do with the problem must be apparent to everyone who has read the judicial opinions which have struggled with its solution.

nation. Taxes which fall in some degree on instrumentalities of the national government or on the fruits of interstate commerce have a double aspect. They are imposed on persons or property or occupations or privileges within the geographical jurisdiction of a state and normally within its legal jurisdiction. They also have some effect on operations within the legal jurisdiction of the United States — a legal jurisdiction assumed to be exclusive. One or the other aspect must be legally predominant, since the same tax cannot be both valid and invalid. But the necessary legal predominance of one aspect cannot obliterate the existence of the other; and the recognized imperative of cleaving only to one does not carry with it any certain indication of the choice between the two. The choice must be made as the cases arise, and without the aid of any rule of universal application. The rule must be the child and not the parent of the cases.

All of the taxes which the Supreme Court has had to consider, from Marshall's day to this, have been demands which it was possible to regard as formally on subjects within the jurisdiction of the state. All have had some effect on interstate commerce or on some operation of the national government. On nearly every crucial question the judges have been in disagreement as to whether the form or the effect should be regarded as controlling. In most important instances this disagreement can be traced to differences of opinion as to the effect to be anticipated from the exercise of state power in question. It may be said, therefore, that the accepted test has always been a judgment on a question of economics, provided it is understood that the judges have been concerned with the economic effect, not of the precise tax before them, but of such a tax levied at the highest rate which a state might be moved to impose. It will not do to accept without qualifications Marshall's statement that "questions of power do not depend on the degree to which it may be exercised," [8] but in general it is true that the court has not forgiven any state tax because the particular rate of levy was so moderate that its effect on national instrumentalities or on interstate commerce was negligible.

The disagreement among the judges which has been characteristic of most of the decisions was not present in *McCulloch* v. *Maryland*.[9] Here the court was unanimous in holding that a Maryland

[8] Brown *v.* Maryland, 12 Wheat. (U. S.) 419, 439 (1819). [9] Note 2, *supra.*

stamp tax on notes issued by the United States bank was a tax on an instrumentality of the national government. The tax was discriminatory, in that it applied only to banks not chartered by Maryland; but the court did not notice this point, and Marshall's opinion is applicable to a nondiscriminatory tax as well. On the other hand the Chief Justice conceded that Maryland might tax the real estate of the bank and the interest of Maryland citizens in the institution "in common with other property of the same description throughout the State." [10] A tax on the issuance of notes was regarded as a tax on the operations of a federal instrumentality; a tax on the real estate was thought to be something else. The only difference between the two appears to be one of degree. One affects or may affect the operations of the bank more seriously than the other.

Brown v. *Maryland* [11] also dealt with a discriminatory tax, and again this was not noted by the court. The law declared invalid required a license of importers of foreign articles and others selling the same by wholesale as a pre-requisite of authority to dispose of them. Retailers of foreign commodities were subject to a companion law. Mr. Justice Thompson dissented. He assumed that retailers would be held taxable and declared that there was no difference in effect between a tax on the wholesaler and one on the retailer. He assumed also that "the law has no relation whatever to the goods intended for transportation to another State," but "applies purely to the internal trade of the State of Maryland." [12] Accepting

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[10] 4 Wheat. (U. S.) 316, 436 (1819).

[11] Note 6, *supra.*

[12] 12 Wheat. (U. S.) 419, 451 (1827). The correctness of this assumption may be doubted. Taney, who argued the case on behalf of the state, later expressed his approval of the decision against his client on the express ground that the tax fell on ultimate consumers in other states. In his opinion in the License Cases, 5 How. (U. S.) 504, 575–76 (1847), he says: "The immense amount of foreign products used and consumed in this country are imported, landed, and offered for sale in a few commercial cities, and a very small portion of them are intended or expected to be used in the State in which they are imported. A great (perhaps the greater) part imported, in some of the cities, is not owned or brought in by citizens of the State, but by citizens of other States, or foreigners. And while they are in the hands of the importer for sale, in the form and shape in which they were introduced, and in which they are intended to be sold, they may be regarded as merely *in transitu*, and on their way to the distant cities, villages and country for which they are destined, and where they are expected to be used and consumed, and for the supply of which they were in truth imported. And a tax upon them while in this condition, for State purposes, whether by direct assessment, or indirectly, by requiring a license to sell, would hardly be more justifiable in principle than a transit duty upon the merchandise when passing through a State."

his assumptions, his economics is satisfactory. He has some excuse for neglecting the fact that sales of foreign goods were discriminated against, since Marshall in the majority opinion did not mention the point and declared broadly that so long as the goods remain imports, their sale in the normal way is immune from state taxation. But Marshall would never have allowed a discriminatory tax on sales of imported goods even by retailers after the articles had ceased to be technical imports within his original-package rule. He expressly says that "we do not mean to give any opinion on a tax discriminating between foreign and domestic articles," [13] although the language of the Maryland Act, warranted placing the decision on the ground of such discrimination.

If we take the case on the assumptions on which the majority and minority proceeded, we have the ruling that a general tax on all wholesalers of goods for use within the state cannot be imposed on those wholesalers who deal exclusively in goods of foreign origin which have not previously been sold or taken from their original package. Such a tax is not within the letter of the constitutional prohibition. It adds to the price of foreign goods no more than it adds to the price of home-made articles. Its encroachment on federal authority is indirect, remote, and negligible. To exempt sales of imports from burdens which sales of domestic goods must bear confers a positive benefit upon dealers in foreign goods, and thereby bestows a bounty on importation. Yet Marshall seemed to think that to deny the bounty would be to impose a burden. Now that the federal tax on net income is held not to be a tax on exports although the income taxed is from an exporting business,[14] a state tax on net income must be permitted to reach income from the sale of imports and escape conviction on the charge of being a tax on imports. Mr. Brown, therefore, if he were doing business in Maryland to-day, would find that he had to include all income from his wholesale business in making his returns for the assessment of a general state income tax, notwithstanding the fact that he was a dealer in imports. Thus *Brown* v. *Maryland* [15] has now technical, rather than substantial, importance. It does not stand in the way

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[13] 12 Wheat. (U. S.) 419, 449 (1827).

[14] Peck & Co. *v.* Lowe, 247 U. S. 165, 38 Sup. Ct. Rep. 432 (1918), 32 Harv. L. Rev. 639.

[15] Note 6, *supra*.

of state taxation of the economic enterprise which in 1827 was relieved of a $50 license fee. It still forbids specific impositions on the business of selling imports, but this goes, not so much to the existence of state power, as to the manner of wielding it. The famous decision would have been more impregnable against the assaults of time if it had been confined to discriminatory taxation. Though the Supreme Court has never relaxed its doctrine that no license fee can be imposed on foreign or interstate commerce, all the license fees with which it has had to deal have been imposed on selected enterprises and have therefore had in them the seeds of discrimination.

Two years after *Brown* v. *Maryland* [16] came *Weston* v. *City Council of Charleston*.[17] Here, too, there was discrimination, for the tax in question was one imposed, not on all property, but on certain selected species, among which "six and seven per cent stock of the United States" was included. In holding the levy on United States stock an invalid interference with the borrowing power of the national government, Marshall made no mention of the fact that such stock was taxed while certain other property went free. Mr. Justice Johnson in his dissent assumed also that there was no discrimination against United States bonds, as is evident from the concluding paragraphs of his opinion:

"Why should not the stock of the United States, when it becomes mixed up with the capital of its citizens become subject to taxation in common with other capital? Or why should one who enjoys all the advantages of a society purchased at a heavy expense, and lives in affluence upon an income derived exclusively from interest on government stock, be exempted from taxation?

"No one imagines that it is to be singled out and marked as an object of persecution, and that a law professing to tax, will be permitted to destroy; this subject was sufficiently explained in McCulloch's case. But why should the states be held to confer a bonus or bounty on the loans made by the general government? The question is not whether their stock is to be exposed to peculiar burdens; but whether it shall enjoy privileges and exemptions, directly interfering with the power of the states to tax or to borrow.

"I can see no reason for the exemption, and certainly cannot acquiesce in it." [18]

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[16] Note 6, *supra*. [17] 2 Pet. (U. S.) 449 (1829), 31 HARV. L. REV. 327–29.
[18] 2 Pet. (U. S.) 449, 473 (1829).

Mr. Justice Thompson also dissented. He understands that the majority means to hold that stock of the United States "is not to be included in the estimate of property subject to taxation" on "the broad ground" that it is "not taxable in any shape or manner whatever." [19] His objection to the decision is that the interference with the United States from permitting the tax is slight as compared with the evil of exempting the property and creating a privileged class of public creditors:

"No one procures stock without exchanging for it an equivalent in money or some other property; all which was, doubtless, subject to the payment of taxes. Exemption from taxation may hold out an inducement to invest property in stock of the United States, and might, possibly, enable the government to procure loans with more facility, and perhaps on better terms. But this possible, or even certain benefit to the United States, cannot extinguish pre-existing state rights. To consider this a tax upon the means employed by the general government for carrying on its operations, is, certainly, very great refinement. It is not a tax that operates directly upon any power or credit of the United States. The utmost extent to which the most watchful jealousy can lead is, that it may, by possibility, prevent the government from borrowing money on quite so good terms. And even this inconvenience is extremely questionable; for the stock only pays the same tax that the money with which it was purchased did. And whether the property exists in one form or the other, would seem to be matter of very little importance to the owner. But great injustice is done to others, by exempting men who are living upon the interest of their money, invested in stock of the United States, from the payment of taxes; thereby establishing a privileged class of public creditors who, though living under the protection of the government, are exempted from bearing any of its burdens. A construction of the Constitution, drawing after it such consequences, ought to be very palpable before it is adopted." [20]

In 1842, *Dobbins* v. *Commissioners of Erie County* [21] held without dissent that a revenue officer of the United States could not be subjected to a state tax imposed on "all offices and posts of profit." The law made it the duty of the assessors "to rate all offices and posts of profit, professions, trades, and occupations, at their discretion, having a due regard to the profits arising therefrom." [22]

[19] 2 Pet. (U. S.) 476.

[20] *Ibid.*, 478.

[21] 16 Pet. (U. S.) 435 (1842).

[22] *Ibid.*, 445.

The tax appears to have been one of the so-called faculty taxes, rather than an income tax. The plaintiff's office was assessed at $500, and the assessments on it for three years had amounted altogether to $10.75. The tax could hardly be called discriminatory, for it reached not only all professions, trades and occupations, but all idle bachelors over the age of twenty-one. The absence of discrimination was called to the attention of the court by counsel for the county, but was not referred to in the opinion. The decision proceeded on the broad ground that the salaries of all officers of the United States are exempt from taxation by the states. It was assumed without analysis that state taxation on federal salaries, whether discriminatory or not, would affect the compensation which the federal government would have to pay its officials. While the opinion as a whole is based on political rather than on economic considerations, Mr. Justice Wayne introduces the latter when he says:

"Is the officer, as such, less a means to carry into effect these great objects than the vessel which he commands, the instruments which are used to navigate her, or than the guns put on board to enforce obedience to the law? These inanimate objects, it is admitted, cannot be taxed by a state, because they are means. Is not the officer more so, who gives use and efficacy to the whole? Is not compensation the means by which his services are procured and retained? It is true it becomes his when he has earned it. If it can be taxed by a state as compensation, will not Congress have to graduate its amount, with reference to its reduction by the tax? Could Congress use an uncontrolled discretion in fixing the amount of compensation, as it would do without the interference of such a tax? The execution of a national power by way of compensation to officers, can in no way be subordinate to the action of the state legislatures upon the same subject. It would destroy also all uniformity of compensation for the same service, as the taxes by the states would be different. To allow such a right of taxation to be in the states, would also in effect be to give the states a revenue out of the revenue of the United States, to which they are not constitutionally entitled, either directly or indirectly, neither by their own action, nor by that of Congress." [23]

Later on the learned justice treats a tax on the salary as equivalent to a prohibition of the receipt of the salary and therefore in direct

[23] 16 Pet. (U. S.) 448.

conflict with the Act of Congress authorizing its payment from the federal treasury.[24]

The element of discrimination which had been present in the three cases decided in Marshall's time, and which had passed unnoticed, received explicit consideration from Mr. Justice Nelson in *Bank of Commerce* v. *New York City* [25] decided in the second year of the Civil War. The learned justice's treatment of the point is not wholly immune from criticism. The tax before him was one on the capital stock of a bank, and the decision was that a tax on the capital was a tax on the property in which the capital was invested, and that such part of this capital as was invested in United States bonds must be excluded from assessment. In answer to the contention that the Weston case did not apply to such a tax, he said:

"It is true that the ordinance imposing the tax in the case of *Weston* vs. *The City of Charleston*, did discriminate between the stock of the United States and other property — that is, the ordinance did not purport to impose a tax upon all the property owned by the taxpayers of the City, and specially excepted certain property altogether from taxation. The only uniformity in the taxation was, that it was levied equally upon the articles enumerated, and which were taxed. To this extent it might be regarded as a tax on the stock *eo nomine.* But does this distinction thus put forth between the two cases distinguish them in principle? The argument admits that a tax *eo nomine*, or one that distinguishes unfavorably the stock of the United States from the other property of the taxpayer, cannot be upheld. Why? Because, as is said, if this power to discriminate be admitted to belong to the State it might be exercised to the destruction of the value of the stock, and, consequently, of the power or function of the Federal Government to issue it for any practical uses. . . . It will be seen, therefore, that the distinction claimed rests upon a limitation of the exercise of the taxing power of the State; that if the tax is imposed indiscriminately upon all the property of the individual or corporation, the stock may be included in the valua-

[24] "The compensation of an officer of the United States is fixed by a law made by Congress. It is in its conclusive discretion to determine what shall be given. It exercises the discretion and fixes the amount, and confers upon the officer the right to receive it when it has been earned. Does not a tax then by a state upon the office, diminishing the recompense, conflict with the law of the United States, which secures it to the officer in its entireness? It certainly has such an effect; and any law of a state imposing such a tax cannot be constitutional, because it conflicts with a law of Congress made in pursuance of the Constitution, and which makes it the supreme law of the land." (16 Pet. (U. S.) 435, 449–50.)

[25] 2 Black (U. S.) 620 (1862), 31 HARV. L. REV. 329.

tion; if not, it must be excluded or cannot be reached. The argument concedes that the Federal stock is not subject to the general taxing power of the State, a power resting in the discretion of its constituted authorities as to the objects of taxation, and the amount imposed." [26]

But the argument need not make any such concession. Whether United States bonds are subject to the taxing power of the state may depend upon the effect of such taxation on the borrowing power of the nation. The effect will vary with the methods adopted. If United States bonds are taxed and securities which compete for buyers are exempted, the former are placed at a disadvantage. The same result does not necessarily follow when all corporations are taxed on their capital irrespective of the securities in which it is invested. Certainly the effect of such a tax differs from the effect of a discriminatory tax, and the concession that a state may not impose a tax "that distinguishes unfavorably the stock of the United States from the other property of the taxpayer" does not in common sense carry an admission that a state cannot impose a tax which avoids any such unfavorable distinction.

Mr. Justice Nelson is to be criticized also for his later assertion that it cannot be a question for judicial determination whether there is discrimination. He thinks that if the state can tax in any way, it must necessarily be free to tax in every way. Restraints against discrimination can be imposed only by the state itself. This conclusion is interwoven with the assumption that any complaint against discrimination goes only to the wisdom or unwisdom of an exercise of power and not to the existence or lawfulness thereof. The absence of any inexorable necessity for such a position is demonstrated by the cases dealing with state taxes on peddlers or property and holding them invalid when goods or the sales of goods of extra-state origin are selected for discriminatory burdens.[27] Congress has made the absence of discrimination the test of state authority to tax the shares of stock in national banks, and the Supreme Court has had abundant practice in applying the test.[28]

That the test of discrimination is often a difficult one to apply may be conceded. Mr. Justice Nelson is on firmer ground when he

[26] 2 Black (U. S.) 620, 629–30 (1862).

[27] Welton *v.* Missouri, 91 U. S. 275 (1875); Darnell *v.* Memphis, 208 U. S. 113, 28 Sup. Ct. Rep. 247 (1908), 31 HARV. L. REV. 573–74.

[28] See 31 HARV. L. REV. 344–69.

lays emphasis on this point in the succeeding paragraph of his opinion:

"There is and must always be a considerable latitude of discretion in every wise Government in the exercise of the taxing power, both as to the objects and the amount, and of discrimination in respect to both. Property invested in religious institutions, seminaries of learning, charitable institutions, and the like, are examples. Can any Court say that these are discriminations which, upon the argument that seeks to distinguish the present from the case of *Weston* vs. *The City of Charleston,* would or would not take it out of that case?" [29]

Such difficulties have had to be solved in dealing with taxes on shares of stock in national banks, but a court may well hesitate to invite them when not required so to do. If United States bonds were taxable as property, investors would undoubtedly find ways to use their funds for purchase of other securities on which the tax burden was actually or apparently lighter. An apparent exemption which was not an actual one would nevertheless affect the market for other securities unfavorably. But these considerations, which might justify a court in refusing to allow United States bonds to be subject to a property tax, are not pertinent to the issue whether they may be included in the assessment of a tax on the capital of a corporation. If the corporation must pay the same tax whatever the rank or title of its investments, it is denied access to places of untaxed refuge which may be open to an individual. It can reduce its tax only by the Samson-like method of diminishing its assets. Mr. Justice Nelson's remarks on the difficulty of applying the test of discrimination may justify a refusal to limit *Weston* v. *City Council of Charleston* [30] to a tax that is patently discriminatory, since the tax there involved was directly on property; but the difficulties which the learned justice suggested were absent from the case before him.

If we put to one side the question of discrimination, we can readily agree that a tax on the capital of a corporation is a tax on the property in which that capital is invested. To tax United States bonds through a tax on corporate capital may have a different effect on the federal borrowing power than to tax them directly, but none the less it is the bonds that are taxed. In *Bank Tax Case,*[31]

[29] 2 Black (U. S.) 620, 631 (1862).

[30] Note 17, *supra.*

[31] 2 Wall. (U. S.) 200 (1864), 31 HARV. L. REV. 330.

which followed *Bank of Commerce* v. *New York City*,[32] Mr. Justice Nelson remarked wisely:

"It is not easy to separate the property in which the capital is invested from the capital itself. It requires some refinement to separate the two thus intimately blended together. The capital is not an ideal, fictitious, arbitrary sum of money set down in the articles of association, but, in the theory and practical operation of the system, is composed of substantial property, and which gives value and solidity to the stock of the institution." [33]

If it is conceived that any and all taxes on federal securities are unconstitutional obstructions to the federal borrowing power, the state should not be allowed to escape from the restriction by calling the securities some book-keeping name. It is clear that in *Bank Tax Case* [34] and *Bank of Commerce* v. *New York City*,[35] the Supreme Court meant to protect federal securities from state taxation in any form. A court could hardly be expected to do otherwise while the Civil War was raging and the government at Washington needed all the support to its credit that was available. It was no time for nice discriminations between burdens and denial of bounties.

A few years later, however, when the conflict between the states had ended, a majority of the Supreme Court allowed a state to impose a tax on the privilege of being a corporation and measure the amount by assets which included United States bonds.[36] Then followed decisions allowing inheritance taxes on bequests of federal securities [37] and permitting the economic value contributed by United States bonds owned by a corporation to be included in the assessment of the shares of stock owned by individuals.[38] So far as appears, federal securities may be a source of state revenue both through a tax on the franchise of a corporation and a tax on the shares owned by individuals. The difference between a tax on

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32 Note 25, *supra*.

33 2 Wall. (U. S.) 200, 208–09 (1865).

34 Note 31, *supra*.

35 Note 25, *supra*.

36 Society for Savings *v.* Coite, 6 Wall. (U. S.) 594 (1868); Provident Savings Institution *v.* Massachusetts, 6 Wall. (U. S.) 611 (1868); Hamilton Co. *v.* Massachusetts, 6 Wall. (U. S.) 632 (1868); Home Insurance Co. *v.* New York, 134 U. S. 594, 10 Sup. Ct. Rep. 593 (1890); 31 HARV. L. REV. 331–35.

37 Plummer *v.* Coler, 178 U. S. 115, 20 Sup. Ct. Rep. 829 (1900), 31 HARV. L. REV. 336.

38 Van Allen *v.* Assessors, 3 Wall. (U. S.) 573 (1866); Cleveland Trust Co. *v.* Lander, 184 U. S. 111, 22 Sup. Ct. Rep. 394 (1902); 31 HARV. L. REV. 339–41.

the capital of a corporation and a tax on its franchise measured by its capital is one between tweedledum and tweedledee. Since taxes on a corporation are in last analysis taxes on the interest of the shareholders in the corporate assets or business, to exclude federal securities from the computation of a tax on the corporate capital and to include them in the assessment of the shares of stock is to allow the state to reach with one hand what it is forbidden to touch with the other. The idea that federal securities cannot be taxed by a state is a mythical fancy so long as such securities belonging to a corporation may enter into the assessment of a tax on the corporate franchise and of a further tax on the interest of the shareholders in the corporation.

The burden put upon the federal borrowing power by such taxation of federal securities in the vaults of corporations is of course a more limited one than would be imposed by their inclusion in all property taxation. But the court in subjecting United States bonds owned by corporations to the fiscal power of a state did not go on any such common-sense distinction. The inclusion of the bonds in the assessment of franchise taxes was sustained on the theory of the absolute power of a state over privileges which it might grant or withhold.[39] The taxation of shares at their full value without deduction of the contribution of United States bonds to that value was approved on the basis of a notion of the "separate individuality" of a corporation and its stockholders.[40] The first of these theories has since been deprived of capacity to enable a state to measure taxes on the local business of foreign corporations engaged also in interstate commerce by the value of their total capital stock.[41] The second has been refused recognition in a recent case [42] in which a state sought to impose double taxation on the economic interest in shares of a national bank owned by another national bank. It had previously been commented on unfavorably by Mr. Justice Moody in *Home Savings Bank* v. *Des Moines*,[43] which found that a

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[39] See passage quoted from Home Insurance case in 31 HARV. L. REV. 334. "No constitutional objection lies in the way of a legislative body prescribing any mode of measurement to determine the amount it will charge for the privileges it bestows."

[40] See passage quoted from the Lander case in 31 HARV. L. REV. 341.

[41] Western Union Telegraph Co. *v.* Kansas, 216 U. S. 1, 30 Sup. Ct. Rep. 190 (1910), and cases following it. See 31 HARV. L. REV. 584–618, 937–53.

[42] Bank of California *v.* Richardson, 248 U. S. 476, 39 Sup. Ct. Rep. 165 (1919).

[43] 205 U. S. 503, 27 Sup. Ct. Rep. 571 (1907), 31 HARV. L. REV. 341–44.

state tax was imposed on the property of a corporation and not on that of its shareholders, as the state court had held. It is therefore apparent that the decisions allowing United States bonds to be taxed through levies on corporate franchises and shares of stock are open to reëxamination.

The decision which thwarted a state's endeavor to get two taxes out of some national bank stock is *Bank of California* v. *Richardson*,[44] decided January 27, 1919. The plaintiff national bank owned shares in another national bank known as D. O. Mills and Company. It was held taxable on those shares on the authority of *Bank of Redemption* v. *Boston*[45] which held that congressional permission to tax the shares of national banks to their owners extended to shares owned by other national banks. The state sought also to tax the shareholders of the plaintiff bank on the full value of their stock without any deduction for that part of the value due to the stock of the Mills National Bank owned by the plaintiff bank. The minority of the court declared that this was within the letter of the congressional permission, and brought to bear the traditional theory that the property interest of the stockholder is essentially different from that of the corporation, and that therefore a tax on the stockholder's interest in the plaintiff bank was not a tax on the property of the plaintiff. But the majority held that the purpose of the congressional permission was to allow but a single tax on national bank shares and that this purpose was defeated if the shares in the Mills Bank, after being taxed directly to the plaintiff bank which owned them, entered into the assessment of another tax on the shares of the plaintiff bank owned by individuals. The notion of "separate individuality" was not allowed to support a result deemed undesirable and in substance, though not literally, without the congressional permission upon which state power over national bank stock is held to rest. The Chief Justice's treatment of the issue is not so sharp as might be desired, but the basis of the decision may be gathered from the following paragraphs:

"It is undoubted that the statute from the purely legal point of view, with the object of protecting the federal corporate agencies which it created from state burdens and securing the continued existence of such agencies despite the changing incidents of stock ownership, treated the banking corporations and their stockholders as different. But it is also

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44 Note 42, *supra*.

45 125 U. S. 60, 8 Sup. Ct. Rep. 772 (1888).

undoubted that the statute for the purpose of preserving the state power of taxation, considering the subject from the point of view of ultimate beneficial interest, treated the stock interest, that is, the stockholder, and the bank as one and subject to one taxation by the methods which it provided. . . . Again, when the purposes of the statute are taken into view, the conclusion cannot be escaped that the transmutation of the stock interest of the California in the Mills Bank, into an asset of the California Bank subject to be taxed for the purpose of reaching its stockholders, is to overthrow the very fundamental ground upon which the taxation of stockholders must rest." [46]

On the basis of this decision, it would be possible to support the contention that United States bonds owned by a corporation, since they must be excluded from the computation of a tax on the capital of the corporation, must also be excluded from a tax on the shares of stock in the corporation. Evidently a majority of the Supreme Court favored this view in 1907, when *Home Savings Bank* v. *Des Moines* [47] was decided, though the contrary view was recognized as too firmly established to be overthrown. It is to be assumed, therefore, that the Supreme Court will continue to permit the states to tax United States bonds owned by corporations through full assessment of their shares of stock. It would be wholesome, however, if some better basis for such taxation could be found than the unsubstantial one that the property of the shareholders is distinct from that of the corporation.

Such a basis appears in the rules which have been worked out in the field of state taxation of interstate commerce. If we discard all the doctrinal disquisitions of the opinions and look only to the results of the decisions, we find that the controlling motive of the Supreme Court has been the desire to prevent the states from imposing on interstate commerce any peculiar or unusual burden. Where the court has been assured that the state did not have a device which might be operated to discriminate against interstate commerce, taxation of that commerce has been allowed. Net income from interstate commerce may be included in a general income tax.[48] Property used in interstate commerce may be assessed by

[46] 248 U. S. 476, 485, 39 Sup. Ct. Rep. 165 (1919).

[47] Note 43, *supra*. See 31 HARV. L. REV. 343.

[48] United States Glue Co. *v.* Oak Creek, 247 U. S. 321, 38 Sup. Ct. Rep. 499 (1918), 32 HARV. L. REV. 634–43.

capitalizing the earnings from the business which it serves.[49] Even gross receipts from interstate commerce may be taxed in the guise of a property tax where the result is no more than a fair equivalent for ordinary property taxation.[50] The decisions sanctioning these results make it clear that a state which confines its taxation to levies on tangible property and on net income will have to take little or no account of the commerce clause. When it imposes license or franchise or occupation taxes, or adopts any other revenue devices which are not certain to fall equally on all enterprise within the state, then it runs the risk of disappointment whenever it seeks to lay its hand on interstate commerce. What the court is insistent upon is that there must be adequate safeguards against subjecting interstate commerce to heavier taxation than local commerce. It does not require the states to confer a bounty upon interstate commerce by exempting it from burdens which competing business must bear.

The substantial reason back of these decisions is that interstate commerce is not prejudiced by a summons to bear its proportionate contribution to the treasuries of the states. So, too, the borrowing power of the United States is not interfered with by proportionate taxation of the obligations created by its exercise. Taxation of the full value of the shares of corporate stock, without inquiry into the character of the corporate property which gives that stock some or all of its value, can seldom, if ever, discriminate against part of that property in favor of another part. A corporation will be likely to buy the same amount of United States bonds whether the shares of its stockholders are taxed at their full value or are entirely exempt. Taxation of the shares is not, in form, taxation of the property of the corporation. Technically, therefore, such taxation does not fall on a federal instrumentality, even when the corporation owns United States bonds. If, then, a tax on the shares does not actually place the United States at a disadvantage in marketing its bonds, there is no basis either formal or substantial on which to require the exclusion of the value contributed by such bonds from the assessment of the shares.

A more difficult problem confronts us when we seek to distinguish between a tax on corporate capital and a tax on a corporate franchise measured by the amount of the capital. The distinction

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[49] 32 HARV. L. REV. 239–65.

[50] 32 HARV. L. REV. 377–416.

is no longer accorded recognition to enable a state to impose on foreign corporations engaged partly in interstate commerce a tax which is in substance on extra-state property.[51] Should it continue to allow a state to tax United States bonds owned by a corporation through the device of a tax on the franchise of a corporation measured by the value of its capital? The answer must depend upon whether there is any substantial reason for holding that a tax directly on the capital must exclude such part thereof as is invested in United States bonds. To require such exclusion is to grant a bounty to the federal borrowing power. The extent of the bounty would be appreciated if the obligations of competing debtors were similarly excluded. The denial of this bounty, therefore, cannot in substance be regarded as an interference with the federal borrowing power. We may accept the conclusions that a tax on corporate capital is a tax on the property in which it is invested, and that a tax on United States bonds is a tax on a federal instrumentality. If, however, some particular tax on that instrumentality does not in fact burden or interfere with its exercise, there is no economic ground on which to declare it unconstitutional. If all other possible grounds are removed by changing the tax from one formally on capital to one formally on a franchise, there is no remaining obstacle to the assertion of state power.

Two objections may be made to the foregoing discussion. The first is that the United States bonds are taxed twice if they are reached through an assessment of the corporate franchise and a further assessment of the shares of stock. This is true. But they can be taxed twice only as the obligations of competing debtors are similarly taxed. This form of double taxation cannot discriminate against one borrower in favor of another. If the corporation and its stockholders will be subject to separate taxation of their respective legal interests without regard to the character of the investments of the corporation, this double taxation cannot exercise any direct influence on the corporation in its choice of investments. On the other hand, if United States bonds are excluded from the assessment of either tax, while the obligations of competing debtors are included in the assessment of both, the federal government has been granted a preference. This answer, it must be recognized, flies in the face of *Bank of California* v. *Richardson*.[52] If that de-

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[51] Note 41, *supra*.

[52] Note 42, *supra*.

cision has any sound economic justification, the Supreme Court ought to apply it to the objection against double taxation now under consideration. The reply is that *Bank of California* v. *Richardson* [53] is not supportable on economic grounds. It must stand or fall on the assumption on which it proceeds, *i. e.*, that Congress has expressly dealt with the problem and permitted but a single tax on the economic interest represented by shares in national banks.[54]

The further objection to the inclusion of United States bonds in assessments of corporate franchises and shares of stock is that such inclusion may in fact operate to deter corporations from investing in those bonds. The argument runs as follows. With the normal difference between the interest rate of public and of private obligations due to the superior security of the former, a tax on capital value would bear more heavily on the bonds with the lower interest rate. Those who might prefer three-per-cent government bonds to six-per-cent railroad bonds, when both were exempt from taxation, would be likely to alter their preference if a two-per-cent tax reduced the income to one and four per cent respectively. The discrepancy would be reduced by the resulting alterations of capital value, but the effect on the borrowing power of the United States would not thereby be lessened. Giving full account to the fact that the capacity of the United States to borrow at lower interest rates than individuals or corporations is due in considerable part to a bounty conferred by the exemption of federal securities from burdens that competitors must bear, it may still be true that the removal of the exemption would in many instances be something more than the denial of a bounty. It may operate practically to deny to the government a part of the advantage conferred by the excellence of its credit. There may be a minimum to the total net income with which an investor will be content without looking for all possible ways of increase. He may look less favorably on three- or four-per-cent bonds subject to a two-per-cent tax, even though six-per-cent

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[53] Note 42, *supra*.

[54] The Chief Justice hints that he could support the case on economic grounds if he had to, but he refrains from elaborating the hint. On page 485 he says: "We do not stop to point out the double burden resulting from the taxation of the same value twice which the assessment manifested, as to do so could add no cogency to the violation of the one power to tax by the one prescribed method conferred by the statute and which was the sole measure of the state authority."

bonds also yield only four per cent net, than on the same three or four per cents when they and the six per cents produce a net yield of those amounts. It is more congenial to give the state a third of one's income from any given source than to divide fifty-fifty. Though a corporation may make a sacrifice of income to gain the benefit of sure and quick assets, its sacrificial spirit is likely to vary inversely with the amount involved in its indulgence. Whether a corporation would be wise to reduce its proportion of high-grade assets because of a diminution in their net yield is not in point. If it would in fact do so, a nondiscriminatory tax on the capital value of all its assets in whatever form imposed, would reduce the market for United States bonds.

Here is an incalculable factor. It may be of considerable or of little importance. An argument against allowing it consideration may be found in the fact that there is no reason why an investor should ever take less interest than he can get, except as he receives other advantages which he regards as compensatory. A corporation which foregoes income to gain security ought to stick to its choice even when pinched by increased taxation or by any other expense. It would have the same inducement to increase its interest receipts, whatever the cause of its decreased net income — whether it has to spend an additional $5,000 for taxes or for increased wages. It could hardly be said that a labor union was interfering with a federal instrumentality because it succeeded in establishing such higher wage schedules that the employing corporation decided to invest henceforth only in seven-per-cent stocks in order to maintain its rate of dividends. The analogy affords a basis for the argument that such effect as taxation of corporate stock or franchise may have to deter the corporation from purchasing high-grade low-interest-bearing securities must be regarded as indirect, since the same effect may be contributed by other factors.

Nevertheless it remains true that taxation measured by the value of securities owned, and which therefore in effect falls on those securities, falls more heavily on securities with the lower interest yield. The ratio between the net yield of public and of private obligations is more favorable to the latter when both are taxed on their capital value than when both are exempt. It may well be, therefore, that state taxation directly on United States bonds should be forbidden on economic grounds. How, then, are we to

justify state taxation indirectly on those bonds? The best answer seems to be that their exemption from direct taxation is not only protection against a burden but also the grant of a bounty. The two cannot be separated. The states, therefore, are required to lend positive aid to the federal borrowing power at considerable sacrifice to themselves. This aid is given to the entire market afforded by individual investors. Such aid may well be credited to the states against any charge that full taxation of corporate shares and franchises deprives the federal government to some extent of the advantages due to its superior credit by making corporations less ready to sacrifice security for income.

It is obvious that the deleterious effect on the federal borrowing power which may possibly ensue from state taxation on the capital value of all stocks and bonds will not follow from state levies on all net income. A two-per-cent tax on the capital value of two $1,000 bonds both selling at par, one issued by the government and paying $30 annually, and the other issued by a private corporation and paying $60 annually, will reduce their net yield to $10 and $40 respectively. The tax takes two-thirds of the income from the government bond and only one-third of the income from the corporation bond. On the other hand a thirty-per-cent tax on the income from the bonds would reduce their net yield to $21 and $42 respectively, leaving the ratio between them the same as when both are exempt. It might therefore be urged that the states should be allowed to include income from federal securities in a general income tax. Such a tax can be called one "upon the person for the general advantages of living in the jurisdiction," [55] or "but a method of distributing the cost of government," [56] or some of the other names that have been found convenient in sustaining taxes. Its effect on the federal borrowing power may be declared "indirect and remote," like the effect on exportation of a tax on net income from an exporting business.[57] It would not, it is conceived, place the federal borrowing power under any disadvantages that it would not labor under if all intangibles were entirely exempted from any form of taxation.

[55] Mr. Justice Holmes, in Fidelity & Columbia Trust Co. *v.* Louisville, 245 U. S. 54, 58, 38 Sup. Ct. Rep. 40 (1917), 32 HARV. L. REV. 655.

[56] Mr. Justice Pitney in United States Glue Co. *v.* Oak Creek, 247 U. S. 321, 329, 38 Sup. Ct. Rep. 499 (1918), 32 HARV. L. REV. 636.

[57] See Mr. Justice Van Devanter in Peck & Co. *v.* Lowe, 247 U. S. 165, 174–75, 38 Sup. Ct. Rep. 432 (1918), 32 HARV. L. REV. 639.

To exclude interest on United States bonds from a general state income tax is to confer upon the federal borrowing power a bounty to the extent of the exemption. To include such income would regulate the activities of the federal government no more than the permitted inclusion of income from interstate commerce regulates that commerce "in a constitutional sense." It seems, therefore, that the reason for the exemption of income from United States bonds from state-wide income taxes must be political rather than economic. It must be a conception that the federal government is entitled to claim from the states a subsidy for its borrowing power.

It is interesting that no case has specifically held that the states cannot include income from federal bonds in a general state income tax. It is clear, however, that until recently, at any rate, the Supreme Court has regarded a tax on income as indistinguishable from a tax on the source of the income. In *Pollock* v. *Farmers' Loan & Trust Co.*,[58] which held that the federal government cannot tax the income from state and municipal bonds, Chief Justice Fuller declared:

"It is contended that although the property or revenues of the States or their instrumentalities cannot be taxed, nevertheless the income derived from state, county, and municipal securities can be taxed. But we think the same want of power to tax the property or revenues of the States or their instrumentalities exists in relation to a tax on the income from their securities, and for the same reason, and that reason is given by Chief Justice Marshall in *Weston* v. *Charleston*, 2 Pet. 449, 468, where he said: 'The right to tax the contract to any extent, when made, must operate upon the power to borrow before it is exercised, and have a sensible influence on the contract. The extent of this influence depends on the will of a distinct government. To any extent, however inconsiderable, it is a burthen on the operations of government. It may be carried to an extent which shall arrest them entirely. . . . The tax on government stock is thought by this court to be a tax on the contract, a tax on the power to borrow money on the credit of the United States, and consequently to be repugnant to the Constitution.' Applying this language to these municipal securities, it is obvious that taxation on the interest therefrom would operate on the power to borrow before it is exercised, and would have a sensible influence on the contract, and that the tax in question is a tax on the power of the States and their instrumentalities to borrow money, and consequently repugnant to the Constitution."[59]

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[58] 157 U. S. 429, 15 Sup. Ct. Rep. 673 (1895).

[59] *Ibid.*, 585–86.

Earlier in the opinion the Chief Justice reviewed the cases forbidding either the states or the nation to tax the salaries of the officers of the other, and plainly regarded the want of national power to tax income from state securities as the complement of an undoubted absence of state power to tax income from federal securities.

Though this immunity of federal securities from state taxation has been regarded as inherent in the federal system created by the Constitution, Congress has taken the precaution specifically to declare that United States bonds shall be exempt from state taxation. The Act of February 25, 1862,[60] specifies that "all stocks, bonds, and other securities of the United States held by individuals, corporations, or associations within the United States, shall be exempt from taxation by or under State authority." The Act of July 14, 1870,[61] mentions "the interest thereon" as well as the bonds. The Act of June 28, 1902,[62] is content with declaring exemption "from taxation in any form by or under State, municipal, or local authority;" but the recent acts under which Liberty Bonds have been issued require the states to refrain from taxing both "principal and interest." [63] Thus the only constitutional question which could now be brought before the court is the existence *vel non* of congressional power to decree the exemption of principal and interest of federal securities from state taxation. No one can doubt that this power will be sustained, even though the court might now be persuaded that the exemption is a bounty rather than the fending off of a burden. If Congress deems that the exigencies of the national government require that national obligations be wholly free from state taxation in any form whatsoever, its judgment will never be overruled by the Supreme Court.

Congress has been content to be silent with respect to state taxation of income from corporate dividends when the corporate income

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[60] 12 STAT. AT L. chap. 33, § 2, p. 346, 8 FED. STAT. ANN. 2 ed., 407.

[61] 16 STAT. AT L. 272. " . . . all of which several classes of bonds and the interest thereon shall be exempt from the payment of all taxes or duties of the United States, as well as from taxation in any form by or under State, municipal, or local authority."

[62] 32 STAT. AT L. 484. This was the statute authorizing the issue of the so-called Panama Canal bonds.

[63] FED. STAT. ANN. — 1918 Supp. 673: ". . . both principal and interest shall be exempt from all taxes or duties of the United States as well as from taxation in any form by or under State, municipal, or local authority." (Act of March 3, 1917.) Similar language is used in the Act of September 24, 1917, FED. STAT. ANN. — 1918 Supp. 684.

is from United States bonds, and state taxation of corporate franchises measured by earnings some of which are from United States bonds. *Flint* v. *Stone Tracy Co.*[64] permitted income from state bonds to be included in the measure of a federal excise on doing business in corporate capacity. *Lynch* v. *Hornby* [65] held that cash dividends paid to stockholders after the effective date of the federal income tax law of 1913 were taxable to them as income, although the dividends were the fruit of a surplus accumulated by the corporation before the enactment of the Sixteenth Amendment. Corporate income which was exempt is taxable when transmuted into stockholder's income. Corporate income which cannot be taxed may be made the measure of a tax on doing business in corporate form. Here are precedents to lean on in sanctioning state taxation of stockholder's income without regard to its economic origin, and state taxation of income from United States bonds when the tax is not formally on income, but on a privilege measured by income.

On the other hand, the distinction between the subject and the measure of the tax was dishonored by the court when Kansas sought to tax extra-state property in the guise of a tax on the privilege of a foreign corporation to do local business in connection with interstate business, [66] and the distinction between the shareholder's interest in the corporation and the property held by the corporation was disregarded when California sought to tax the stockholders of a national bank on the full value of their shares, without deduction for the contribution made to that value by the shares of another national bank owned by the corporation.[67] Obviously in dealing with the issues now under consideration the Supreme Court is at liberty to accept or reject formal distinctions as it chooses. That is one of the characteristic merits and demerits of formal distinctions. It is a demerit in that it makes prophecy and logical consistency difficult or impossible. It is a merit in that it permits a court to reach such results as its best judgment dictates.

We have already indicated the reasons which may be advanced, in support of the position that the Supreme Court should adhere to

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[64] 220 U. S. 107, 31 Sup. Ct. Rep. 342 (1911).
[65] 247 U. S. 339, 38 Sup. Ct. Rep. 543 (1918).
[66] Note 41, *supra*.
[67] Note 42, *supra*.

its formal distinctions and permit income from federal securities to be taxed by the states through excises on corporate franchises and through taxes on corporate dividends. If considerations of substance do not require exclusion of United States bonds from assessments of corporate franchises and shares of stock, *a fortiori* such assessments should be permitted to include income from United States bonds. Such taxes measured by income do not deprive borrowers with superior credit of any advantage which that credit gives. Double taxation of stockholder and corporation does not influence the choice of corporate investments. And any margin of error in such calculations is more than offset by the bounty conferred on the federal borrowing power by exemption of interest on United States bonds from an income tax which feeds on interest from competing obligations.

Thus there appears to be no substantial reason for adding new limitations to the power of the states to levy taxes which fall indirectly on federal instrumentalities. The distinction between taxes on corporate capital and taxes on corporate franchises or on shares of stock may be artificial, but it serves a useful purpose; and this on the whole is the most reliable test of the merit of a distinction. Since taxes directly on United States bonds do not have the serious effect on the federal borrowing power which judges of the Supreme Court have often assumed, there is good sense in not extending to indirect taxation the prohibitions against direct taxation. Animated by such good sense, the Supreme Court has allowed the states to tax income from interstate commerce and the United States to tax income from an exporting business. It has appreciated that a general tax on all net income does not cast any unwarranted burden on any particular enterprise from which such income issues. If the Supreme Court were making the law of the Constitution *de novo*, it might therefore be expected to allow the states to tax interest on federal securities and income from federal salaries, granting to the United States a similar power over the fruits of state functions. The economic implications of *Peck & Co.* v. *Lowe* [68] and *United States Glue Co.* v. *Oak Creek* [69] are opposed to the economics underlying *Pollock* v. *Farmers' Loan & Trust Co.*,[70] *Dobbins* v. *Com-*

[68] Note 14, *supra*.

[69] 247 U. S. 321, 38 Sup. Ct. Rep. 499 (1918), 32 HARV. L. REV. 634 *ff*.

[70] Note 58, *supra*.

missioners of Erie County,[71] and *Collector* v. *Day*,[72] and thus afford a convenient excuse for abandoning the decisions of earlier decades.[73]

Unfortunately for any such possibility, Congress insists on denying to the states the power to tax income from federal securities. It thereby requires the states to lend their aid to the federal borrowing power. There seems, therefore, a strong political argument in favor of continuing to forbid the United States to tax income from state securities. Indeed, the argument may be deemed an economic one. We may grant that the effect of exempting interest on state bonds from a general federal tax on net incomes is to confer a bounty on the state borrowing power. But this is not the whole of the story. Such bounty cannot be considered apart from the bounty which the states are required to bestow on the federal borrowing power, to the consequent restriction of their own taxing power. The principle on which these limitations are based is that the federal system requires that neither the state nor the nation exercise their undoubted powers to the detriment of the undoubted powers of the other. No application of this principle can be considered apart from the other applications. What is sauce for the goose should be sauce for the gander. It is a poor rule that does not work both ways. The states receive no more than fair economic treatment if, in return for the aid and comfort which they render the

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[71] Note 21, *supra*.

[72] 11 Wall. (U. S.) 113 (1871). This case held that a federal income tax cannot be applied to the income of a state judicial officer. The court regarded the exemption of state salaries from a federal income tax as the necessary correlative of the exemption of federal salaries from state taxation, Mr. Justice Nelson observing: "And if the means and instrumentalities employed by that government to carry into operation the powers granted to it are, necessarily, and, for the sake of self-preservation, exempt from taxation by the States, why are not those of the States depending upon their reserved powers, for like reasons, equally exempt from Federal taxation? Their unimpaired existence in the one case is as essential as in the other. It is admitted that there is no express provision in the Constitution that prohibits the general government from taxing the means and instrumentalities of the States, nor is there any prohibiting the States from taxing the means and instrumentalities of that government. In both cases the exemption rests upon necessary implication, and is upheld by the great law of self-preservation; as any government, whose means employed in conducting its operations, if subject to the control of another and distinct government, can exist only at the mercy of that government. Of what avail are these means if another power may tax them at discretion? (11 Wall. (U. S.) 113, 127.)

[73] For suggestions that the later decisions furnish the ground for overruling the earlier ones, see note on Peck & Co. *v.* Lowe, and the Oak Creek case, in 4 BULLETIN OF THE NATIONAL TAX ASSOCIATION, 26.

federal borrowing power, they receive a corresponding advantage for their own borrowing power.

The same considerations apply to taxation of income from official salaries. In this field the Supreme Court may, if it wishes, overrule *Collector* v. *Day*,[74] and permit the inclusion of state salaries in the federal income tax, and overrule *Dobbins* v. *Commissioners of Erie County*,[75] and permit the states to tax the salaries of federal officials. A salary exempt from a tax which other salaries must bear is increased by that much. Now that we have a federal income tax, a $5,000 professorship in a state university yields more than a $5,000 professorship in an endowed institution of learning. In the absence of a state income tax, a $6,000 federal judgeship is worth no more than a $6,000 law practice. A state income tax makes the ermine more attractive than it was before. The law as it now stands makes the states and the United States undergo sacrifices, each for the benefit of the other. Neither government would suffer appreciably if the burnt offering were no longer required. But if it is required of either, it should be required of both. So long as Mr. Dobbins is exempt, Mr. Day should be also. The considerations which justify exempting either of them are political rather than economic. While from the political standpoint there is more reason to apprehend state encroachment on federal power than federal encroachment on state power, this can hardly justify a court in holding that a state tax on a federal salary interferes with a federal instrumentality, if a federal tax on a state salary is thought to be immune from criticism.

The conclusion to be drawn from our review and analysis of the decisions is that, in spite of cross currents and shifting winds of doctrine, the states will be permitted to continue the indirect encroachments on federal authority that have hitherto been sanctioned. They will be allowed to impose taxes that fall on interstate commerce and on the federal borrowing power, if they do it in approved ways. The decisions under the commerce clause may nearly all be referred to the judicial conviction that the federal system demands that the states shall not discriminate against interstate commerce, or indulge in forays on property or business beyond their borders, but does not demand that interstate commerce be relieved from proportionate contributions. The decisions which have permitted

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[74] Note 72, *supra*.

[75] Note 21, *supra*.

state taxation which falls indirectly on the federal borrowing power are satisfactorily explained on the economic ground that they have not hampered that borrowing power. There is ample economic justification for the cases which have restrained the states from laying discriminatory taxes on United States bonds. For the other restrictions which the Supreme Court has placed upon the states we must be content with political rather than with economic reasons.

In choosing between competing political considerations, much depends on personal predilections. Two of Marshall's colleagues did not share his views that United States bonds must be exempt from state taxation. What Marshall's doctrine achieved was a protective tariff in favor of the infant industry of national credit. His fears that the nation might be destroyed if the view of the dissent had prevailed must be regarded as extravagant. But this does not question the fundamental wisdom of his judgment, particularly at the time when it was rendered. Congress plainly believes that the judgment is as sound to-day, since it demands the continuance of the protection which Marshall decreed. It is difficult to quarrel with the position that the powers of the nation shall be immune from the direct touch of the states. In determining the constitutionality of state taxation which falls directly on federal instrumentalities, we can readily forego nice analysis as to its economic effects. But an understanding of those effects is essential to a proper evaluation of the decisions which permit state taxation that falls indirectly on those same instrumentalities. Distinctions between direct and indirect effect which seem unsubstantial, when abstracted from the complete situation in which they play their part, are found to be useful implements for reaching desirable results. In permitting indirect encroachment on federal authority by the taxing powers of the states, the Supreme Court has been wise in its judgments. If its conclusions deserve more praise than does some of the reasoning by which they have been supported, the phenomenon is not peculiar to the particular problem which we have been considering.

The explanation of the unsatisfactory character of so much of the judicial reasoning here and elsewhere is easily discovered. Decisions which are dictated by the necessity of making a wise practical choice between competing considerations are seldom placed frankly

on that ground. Judges are loth to say: "We decide this particular case in this particular way because we think that this is the best way to decide it." Instead, they are prone to refer their judgment to some immutable principle inherent in the nature of things, or unalterably established by the authoritative judgments of their predecessors. In the realm of constitutional law, courts are fond of professing that it is not they that speak, but the Constitution that speaketh in them, even in settling such disputes as this study has chronicled, concerning which concededly the Constitution is silent. Where the Constitution is not wholly mum, it often speaks with such a still, small voice that only a bare majority of the court can hear its echo. Yet the judicial opinions seldom recognize the patent fact. So long as judges pose as automatons when they are in fact wise arbiters of public policy and practical expediency, they necessarily hide their wisdom under the bushel of a supposed constraining conceptualism, which confuses much that would otherwise be simple and clear. The wonder is that wisdom so generally finds its way and controls the actual adjudications which together make the law. This could hardly be, if doctrine played any such potent part in shaping the course of the decisions as the opinions of the judges would lead us to believe.

The judicial umpiring of the contests between the conflicting claims of the states and of the nation over the exercise of the taxing power has clearly not been controlled by any undisputed and compelling doctrine. That is why it has so greatly perplexed those who see in doctrine their only guide. To dispel the perplexity we must study the cases as practical adjustments of competing interests, each of which is entitled to a degree of consideration. The interest which will be accorded the preference in one situation may have to be determined in the light of the preferences which have been accorded in other situations. No single adjustment liveth to itself alone. In a federal system there must be reciprocal give and take between the whole and the several parts. It must often be impossible in particular instances to make an even apportionment of the giving and the taking. So it may be necessary to favor now one side, and now the other. The aim should be to strike as even a balance as possible in the whole account. This can never be done by pious invocation of some image which men choose to call "Sovereignty." It must be done, as it has been done, by applying human

intelligence to the enterprise of forecasting and evaluating the practical results from differing courses of action, and of choosing that course which leads to the result preferred. Marshall pursued a vain hope in thinking it possible to "measure the power of taxation residing in the State by the extent of sovereignty which the people of a single State possess and can confer on its government." We can, however, if we find it necessary, measure to a considerable degree the extent of sovereignty residing in the state, by finding what the official interpreters of the Constitution permit the state to do in the exercise of the power of taxation and of other governmental functions. "Sovereignty" is a way of stating results rather than a means of reaching them.

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